

AVISTA CORP.
RESPONSE TO REQUEST FOR INFORMATION

JURISDICTION:	WASHINGTON	DATE PREPARED:	10/19/2016
CASE NO:	UE-160228 & UG-160229	WITNESS:	Mark Thies
REQUESTER:	Bench	RESPONDER:	Pat Gorton
TYPE:	Bench Request	DEPT:	Treasury
REQUEST NO.:	Bench Request No. 5	TELEPHONE:	(509) 495-4353
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REQUEST:

Please provide the updated cost of debt information related to the \$175 million First Mortgage Bond issuance noted within Company witness Ms. Andrews' rebuttal testimony (Exhibit No. (EMA-6T)), at page 14, lines 3-10.

RESPONSE:

As noted at page 14 of Exhibit No. (EMA-6T), lines 3-10, on rebuttal the Company updated its cost of debt from 5.51% to 5.594%¹. In August 2016 Avista priced \$175,000,000 of First Mortgage Bonds due in 2051 (35 years) with a coupon rate of 3.54%, through a private placement offering with the bonds to be funded and issued in December 2016. Including transaction costs and the cost of hedges, the all-in-rate is 5.63% over the 35-year period. This revises the Company's Rate of Return (ROR) from 7.64% to 7.68%. This update increases the Company's revenue requirement by \$624,000, and an incremental amount of \$8,000 in 2018.

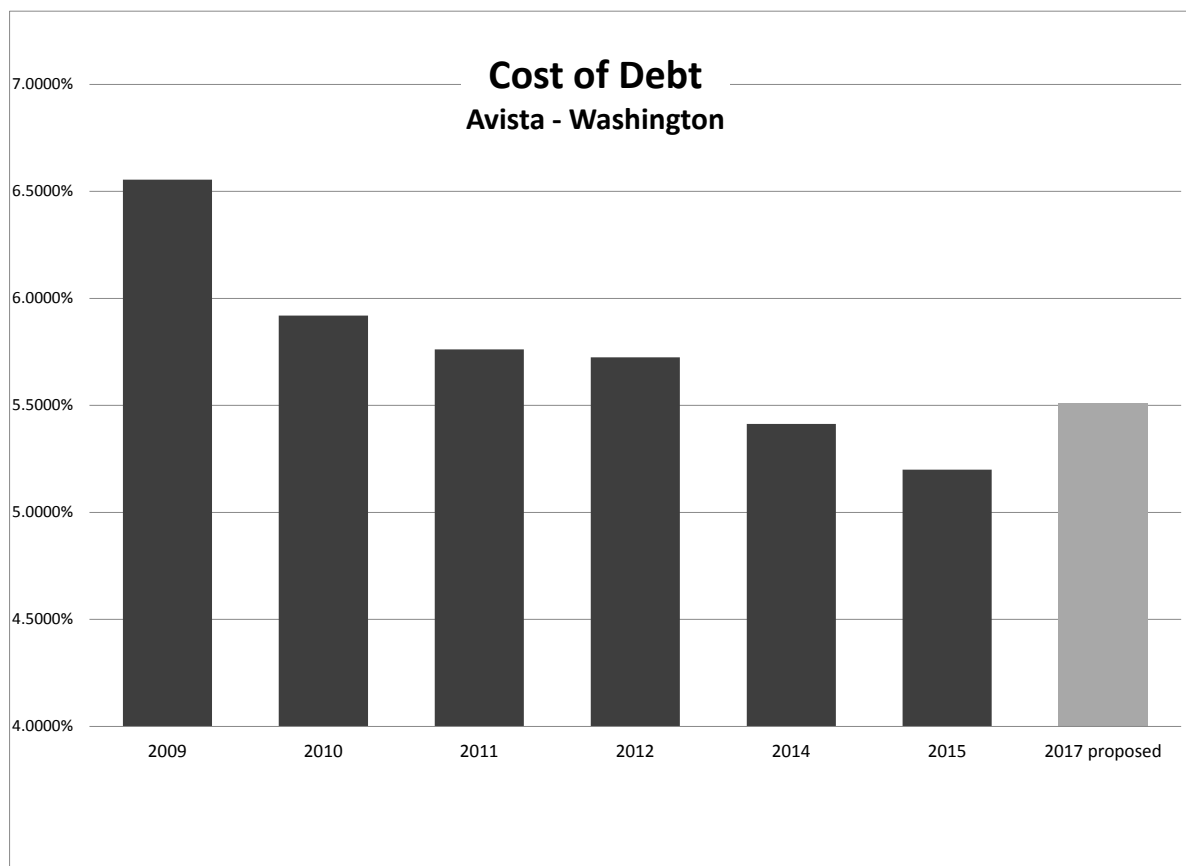
Attached to this response as Bench Request No. 5 – Attachment A is the information provided to all parties on August 8, 2016 regarding this change in cost of debt. The issuance and swap (or hedge) costs are shown on page 2 of Attachment A, line 19.

With regard to the question asked by Commissioner Jones at the hearing related to the increase in the overall cost of debt from the last rate case of 5.20% to the originally proposed cost of debt in this case of 5.51%, the primary reason for the increase is the "rolling off" of \$90 million of essentially zero cost debt in August 2016. In August 2013 the Company issued \$90 million of debt with a three-year term and with a coupon rate of 0.84%. Avista executed interest rate hedges related to a portion of this debt, and at the time the debt was issued received a benefit of \$2.9 million related to the hedges. This benefit was amortized over the life of the debt, which resulted in a below-zero effective yield of -0.04 percent. The maturation of the \$90 million debt issuance in August 2016, and the estimated cost, at the time we filed this rate case, of replacing it with new long-term, higher-cost debt was the primary driver in the increase in the overall debt cost from 5.20% to 5.51%.

This increase, resulting primarily from the maturity of the below-zero cost debt, was illustrated in a bar chart from Mr. Thies' direct testimony, Illustration No. 5 in Exhibit No. MTT-1T on page 22, which is reproduced below.

¹ This update to the cost of debt was provided to all parties on August 8, 2016 in supplemental response to Staff_DR_030-Supplemental 2 (Attrition model update) and August 9, 2016 in supplemental response to Staff_DR_091-Supplemental 3 (Pro Forma/Cross Check model update).

Illustration No. 5



As noted by Mr. Thies in his direct testimony (Exhibit No. MTT-1T), starting at page 15, in the next five years the Company is obligated to repay maturing long-term debt totaling \$504.5 million. The table in Illustration No. 3 on page 16 of his direct testimony, reproduced below, shows the Company's maturing long-term debt from 2016 through 2020, including the \$90 million maturity in August 2016.

Illustration No. 3

Avista Corp Long-Term Debt Maturities, 2016-2020				
Maturity Year	Principal Amount	Coupon Rate	Date Issued	Maturity Date
2016	\$90,000,000	0.84%	8/14/2013	8/14/2016
2017	-	-	-	-
2018	\$7,000,000	7.39%	5/11/1993	5/11/2018
	\$250,000,000	5.95%	4/3/2008	6/1/2018
	\$15,500,000	7.45%	6/9/1993	6/11/2018
2019	\$90,000,000	5.45%	11/18/2004	12/1/2019
2020	\$52,000,000	3.89%	12/20/2010	12/20/2020
Total	\$504,500,000			

In recent years there has been a general decline in interest rates while Avista has refinanced maturing debt and issued new debt, causing the Company's overall cost of debt to decrease, which can be seen in Illustration No. 5 above. We have been managing our interest rate risk in anticipation of debt issuances, which has involved fixed rate long-term debt with varying maturities, and executing on our interest rate

risk mitigation program for our forecasted debt issuances. From 2011 through 2015 we issued \$415 million in long-term debt. The weighted average coupon rate of these issuances was 3.55% (with an all-in rate of 3.95%). These issuances have varying maturities ranging from 3 years to 35 years, and a weighted average maturity of 23.6 years.

The Company's Interest Rate Risk Management Plan, which was provided as Confidential Exhibit No. MTT-3C, is designed to reduce uncertainty of the effective interest cost of future debt issuances. The plan provides guidelines for hedging a portion of interest rate risk with financial derivative instruments. We settle these hedge transactions for cash simultaneously when a related new fixed-rate debt issuance is priced in the market. The settlement proceeds (which may be positive or negative) are amortized over the life of the new debt issuance. The Interest Rate Risk Management Plan provides that hedge transactions are executed solely to reduce interest rate uncertainty on future debt issuances for the next five-year period.

The Interest Rate Risk Management Plan policy document was finalized by the Company August 1, 2013. Avista presented the Interest Rate Risk Management Plan to the commission staffs of Washington, Idaho and Oregon, and periodically presents, or offers to present, updates to commission staffs. Similar to the hedging program for our natural gas and power commodity costs, the Company follows the parameters established within its interest rate hedging program to layer in some level of interest rate certainty for a portion of its future debt issuances through interest rate hedges. The Company considers a blend of varying debt maturities (e.g., 10-year debt, and 35-year debt) as part of managing the overall long-term cost of debt for our customers. In the instance of the recent \$175 million issuance, it represents a 35-year long-term debt issuance as part of the overall blend of total outstanding debt. The issuance of long-term debt is intended, in part, to match the long-term nature of our investments in utility infrastructure. Even with this \$175 million issuance, the overall cost of debt is still below the overall cost for 2012 and for prior years (prior to the below-zero cost of debt issued in 2013), as shown in Illustration No. 5 above.

As noted earlier, interest rate hedges can result in either a benefit or cost. Recent examples provided on page 23 of Mr. Thies' direct testimony (Exhibit No. MTT-1T) are as follows:

Our most recent issuance (in 2015) was \$100 million of first mortgage bonds with a thirty year maturity at a rate of 4.37%. This new debt has an effective cost of 5.01% after taking into account issuance costs and the settlement of interest rate hedges.

The prior year (in 2014) we issued \$60 million of first mortgage bonds with a thirty year maturity at a rate of 4.11%. This debt, which matures in 2044, was the lowest priced debt with a term beyond twenty years that the Company has issued since the 1950s. The effective cost of this debt is even lower at 3.65%, which includes cost of issuance and the impact of interest rate hedges. The \$5.4 million positive value of the interest rate hedges (hedges were settled when the coupon rate was set) improved the effective yield on this debt by 0.52%.

Another example, with a shorter maturity, occurred in September 2009 with a principle amount of \$250 million maturing in 2022 with a coupon rate of 5.125%. Including the \$10.8 million benefit from the interest rate hedge reduced the all-in-rate to 4.907% (see page 3, line 12 of Exhibit No. MTT-2C).

We have continued to issue debt with varying maturities to balance the cost of debt and the weighted average maturity. This practice has provided us with the ability to take advantage of historically low rates on both the short end and long end of the yield curve. The Company's credit ratings have supported reasonable demand for Avista debt by potential investors. We have further enhanced credit quality and reduced interest cost by issuing debt that is secured by first mortgage bonds.

We plan to continue issuing long-term debt with various maturities for the foreseeable future in order to fund our capital expenditure program and long-term debt maturities. As noted by Mr. Thies in his direct testimony, the Company is forecasting \$1.2 billion in capital expenditures over the next three years. Additionally, we have \$362.5 million of debt maturing during the same period. This results in a significant need for the issuance of long-term debt to fund these capital expenditures and maturing debt while maintaining an appropriate capital structure. We usually rely on short-term debt as interim financing for capital expenditures, with issuances of long-term debt in larger transactions approximately once a year. As a result, we access long-term debt capital markets on limited occasions, so our exposure to prevailing long-term interest rates can occur within a short period of time rather than across market cycles. To mitigate interest rate risks, we hedge the interest rates for a portion of forecasted debt issuances over several years leading up to the date we anticipate each issuance. We also manage interest rate risk exposure by limiting the extent of outstanding debt that is subject to variable interest rates rather than fixed rates. In addition, we issue fixed rate long-term debt with varying maturities to manage the amount of debt that is required to be refinanced in any period (looking ahead to its future maturity), and to obtain rates across a broader spectrum of prevailing terms which tend to be priced at different interest rates.